Office of Chief Counsel
Internal Revenue Service

memorandum

TAB 3

CC:SER:KYT:NAS:TL-N-3059-00
HPLevine, ID# 62-09574

date: JUN 27 2000

to: District Director, Kentucky-Tennessee District
Attention: Revenue Agent Don Kotval

from: District Counsel, Kentucky-Tennessee District, Nashville

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subject: [redacted]
Depreciation of golf course turf as a land improvement

The National Office orally advised us on June 14, 2000 that they agreed with the memorandum dated June 2, 2000, in which we concluded that the golf course replacement turf could not be depreciated since it was properly characterized as a land improvement.

The National Office expressed concern over our analysis of the hazards which included a discussion of the Simon, Liddle and Selig cases. These cases do not represent the Internal Revenue Service's position. Rather, the Internal Revenue Service's position is that wear and tear that can be corrected with periodic maintenance is not depreciable. The purpose of this discussion was merely to reflect the hazards and we suggest that this discussion not be included in the Form 5701 or revenue agent's report.

(b)(5)(DP) [redacted]

First, grass course turf has historically been considered to be a non-depreciable land improvement. Second, the wear and tear is easily correctable with periodic maintenance or in some instances without any maintenance (certain types of turf are self-regenerating). Therefore, we believe (b)(5)(AC) [redacted]

In terms of factual development, the National Office was concerned that the fact that the taxpayer replaced the turf after only six (6) years was indicative of the excessive wear and tear that it suffered. We suspect that the decision to replace the turf had less to do with its longevity and more to do with the type of image that the taxpayer sought to convey. In this regard, we suggest the following as possible avenues of factual development:

- You may want to determine whether the expenditure of $[redacted] required Board of Director approval. If so, then there may be minutes explaining the reason why the turf was replaced.

- You may want to determine the steps taken by the taxpayer when the golf course was initially built to determine the best type of turf, who it relied upon, why it ultimately went with the bermuda and how much was spent in this regard.

- You may also want to determine if any legal steps were taken against the golf course architect or consultant who recommended the original turf which was ultimately replaced. The lack of action may indicate that the turf performed as expected but that the taxpayer had a change of opinion for purposes other than wear and tear.

- We also suggest that you determine from an industry perspective the types of grass used at comparable facilities in the same geographical area in order to determine whether other similarly situated courses have turf problems consistent with those claimed by the taxpayer. In this regard, this information should be widely available on a comparable course basis or an industry basis including such resources as universities and colleges which offer golf course maintenance degrees and from golf course superintendent trade organizations.

Please contact the undersigned at 250-5072 if you have any questions. Since no further action can be taken at this time, we are closing our file subject to reopening if additional assistance is necessary.

JAMES E. KEETON, JR.
District Counsel

By: _____
HOWARD P. LEVINE
Senior Attorney

Office of Chief Counsel
Internal Revenue Service

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DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

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ISSUE:

1. Whether the taxpayer can depreciate the cost of replacement golf course turf as a land improvement?

CONCLUSION:

1. The taxpayer cannot depreciate the cost of replacement golf course turf as a land improvement since it is "inextricably associated" with the land and since subsequent operating expenses needed to maintain it are currently deductible.

FACTS AND DISCUSSION:

For the years under examination, [redacted] as the successor to [redacted] is the taxpayer. The taxpayer owned a [redacted] and a golf course. The golf course hosts an annual [redacted] golf tournament. The golf course was initially constructed with bermuda grass. It was subsequently determined that the bermuda grass did not wear well for the traffic expected of the course to allow it to be maintained in the desired condition. In [redacted], the bermuda grass was replaced with zoysia grass at a cost of $[redacted]. The taxpayer treated the cost as a land improvement over a [redacted]-year class life and not as non-depreciable land.[1]

Personal property that suffers exhaustion, wear and tear or obsolescence is depreciable. In Simon v. Commissioner, 103 T.C. 247 (1994), aff'd., 68 F.3d 41 (1995), the court found that in order to be depreciable under I.R.C. § 168(c)(1) as recovery property, it must be: (1) tangible property; (2) of a character subject to depreciation, and (3) used in a trade or business or held for the production of income. The primary issue in determining whether the cost for the zoysia grass is depreciable is whether it is "inextricably associated" with the land. Blair v. Commissioner, 29 T.C. 1205 (1958) (grass, shrubs and other landscaping were "inextricably associated" with the land and therefore not depreciable). The historical rationale behind this is that land improvements with an unlimited useful life or at least an indeterminable useful life, such as golf course turf, are not depreciable. Everson v. United States, 108 F.2d 234 (9th Cir. 1997). Accord, The Edinboro Company v. United States, 224 F.Supp. 301 (WD Penn. 1963) (golf course components undistinguishable from the land which is molded and shaped to form them). See also Rev. Rul. 55-290, 1955-1 C.B. 320 (expenditures incurred in the original construction of golf course greens constitute capital expenditures to be added to the cost of the land).

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[1] Although you have not requested that we address the disposition of the bermuda grass, we suggest that you determine how the taxpayer treated this item. The taxpayer may be entitled to an abandonment loss under Treas. Reg. § 1.167(a)-8(a)(4) if the bermuda grass was a depreciable asset or under Treas. Reg. § 1.165-2 if it was a nondepreciable asset. See Scott v. Commissioner, T.C. Memo. 1979-29; Thompson v. United States, 338 F.Supp. 770 (ND Ill. 1971).

Although we believe that the Internal Revenue Service has an argument that the cost of the replacement zoysia grass should be added to the cost of the land and not depreciated as a land improvement, the Internal Revenue Service has substantial hazards of litigation on this issue, especially in the Tax Court. The court in Simon v. Commissioner, supra, defined "of a character subject to allowance for depreciation" to reflect that the property must suffer exhaustion, wear and tear or obsolescence. The court indicated that appreciation of asset did not in and of itself prevent the taxpayer from claiming depreciation, finding that two different concepts were involved, to wit: (1) physical depreciation; and (2) accounting for changes in the asset's value based on market price fluctuations. The court noted that depreciation was designed to allow taxpayers to recover the cost of a business asset through annual depreciation deductions.

The trial and appellate courts first in Simon v. Commissioner, supra and then in Liddle v. Commissioner, 103 T.C. 285 (1994), aff'd., 65 F.3d 329 (3rd Cir. 1995), allowed the respective taxpayers to depreciate an antique violin bow and violin. The Tax Court specifically rejected the Internal Revenue Service's argument, which formed the basis for a strong dissent, that an asset did not suffer wear and tear and therefore was not of a character subject to allowance for depreciation if the wear and tear could be arrested with regular maintenance. That the wear and tear did not appreciably affect the useful life of the asset because of the regular maintenance also formed the linchpin for the Internal Revenue Service's positions in Rev. Rul. 55-290, 1955-1 C.B. 320 and The Edinboro Company v. United States, supra.[2]

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[2] There may be a question as to which circuit would be proper in the event of an appeal. Under I.R.C. § 7482(b)(1)(B), appeal by a corporation is proper in the circuit where the principal place of business is located. Although the taxpayer is a Delaware corporation, from which cases are appealable to the Third Circuit, which decided the Liddle case, the principal place of business is located in Tennessee, from which cases are appealable to the Sixth Circuit. The "inextricably associated" standard was applied in Eastwood Mall Inc. v. United States, 95-1 USTC ¶ 50,236 (ND Ohio 1995), affirmed by unpublished disposition, 59 F.3d 160 (6th Cir. 1995).

It is undisputed that the golf course turf grass suffers wear and tear and requires substantial daily maintenance. See The Edinboro Company v. United States, supra. If the course ignores the wasting aspect of the wear and tear, then it is probable that the court will allow depreciation on the turf grass.[3] See also Selig v. Commissioner, T.C. Memo. 1995-519, where the court in allowing depreciation for exotic automobiles that were exhibited for show on the basis that they suffered obsolescence indicated that business assets that did not suffer wear and tear need not prove a determinable useful life, but that assets that did not suffer wear and tear were required to.

Under the approach currently adopted by the Tax Court, once it is determined that an asset suffers wear and tear, it is depreciable notwithstanding the lack in diminution in value of the asset caused by the wear and tear. The useful life of the asset, which formed the basis for the "inextricably associated" with the land standard, is irrelevant under this analysis. Although there are hazards in proceeding on this issue, this case may provide a good litigation vehicle for contesting the Simon, Liddle and Selig depreciation standards currently followed by the Tax Court since the wear and tear can be arrested with regular maintenance.

Because of the technical nature of this issue, we are seeking post-review by the National Office of the advice contained herein. We expect to hear shortly from them and we suggest that you wait to further hear from this office before you make a final determination on these issues. Attached is a client survey which we request that you consider completing. Please contact the undersigned at 250-5072 if you have any questions.

JAMES E. KEETON, JR.
District Counsel

By: _____
HOWARD P. LEVINE
Senior Attorney

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[3] In this regard, based on Hospital Corporation of America v. Commissioner, 109 T.C. 21 (1997), the court may also attempt to analogize the zoysia turf grass to building carpet and allow it to be depreciated separate from the structure (in this case land) to which it is attached.